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IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

EXXON CORPORATION,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

REPLY MEMORANDUM FOR THE PETITIONER

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REPLY MEMORANDUM FOR THE PETITIONER

This case is full of difficult and substantial questions concerning the justice and legality of an extraordinary monetary exaction. It is regrettable that the government dismissively papers over the difficulties of the case and obscures the many ways in which the agency and the lower courts have departed from fundamental principles of administrative due process.[1]

The government creates a very misleading impression of the factual and regulatory context in which this case arose. *First*, the government inaccurately portrays the events leading up to, and the economic consequences resulting from, unitization at Hawkins Field. The government alleges that Exxon and the other interest owners knew that adoption of a unit BPCL would be required upon unitization and that they nonetheless voted to unitize because "[u]nitization was attractive even under the unit BPCL requirement . . . " Br. in Opp. 14 n.12. *See also id.* at 9, 19 & n.19. The government both misrepresents the evidence and disregards—as it does throughout its brief in opposition—the rule that, on summary judgment, the facts and the record must be construed in the light most favorable to the nonmovant. *See, e.g., Adickes v. S. H. Kress & Co.*, 398 U.S. 144, 157 (1970).[2] At the time of unitization, Exxon did not believe or advise the other interest owners that a unit BPCL would be required. *See* Pet. 7. In alleging the opposite, *see* Br. in Opp. 9, the government quotes from an internal Exxon memo-

[1] The government even makes the Orwellian suggestion that Exxon has been made the beneficiary of "lenient," "relaxed," "less stringent" treatment. Br. in Opp. 6, 20. The district court explicitly rejected those characterizations. Pet. App. 211a-212a.

[2] Exxon moved for summary judgment on certain regulatory issues but took the position that central questions in the case—in particular, the occurrence of a significant alteration in producing patterns and the existence of a reasonable alternative date for adoption of a unit BPCL—were inherently factual and required a trial. R. 27682-85, 30423-28.

randum that was not distributed to the other interest owners. R. 16832-34. The memorandum had been prepared before Exxon became aware that FEA was advising other producers that the regulations permitted units to continue lease-by-lease accounting, and it was that advice which "formed the basis for [Exxon's] decision to alter its prior practices [at other units] and adopt individual lease accounting at the Hawkins Field." Pet. App. 232a. Unitization would not have taken place if the interest owners had known that a unit BPCL would be required. *See* Pet. 5-6, 21. Requiring immediate adoption of a unit BPCL would render the entire unitization project seriously uneconomic, because the loss of large quantities of new oil caused by immediate adoption of a unit BPCL would more than offset the additional revenues generated over time by enhanced recovery. *See id.* at 6 and n.7.[3]

Second, the government makes much of the fact that, after unitization, production at Hawkins Field increased at some leases and decreased at others; indeed, the government appears to assert that this "shift of production" alone mandated adoption of a unit BPCL. *See* Br. in Opp. 4, 10, 12, 20, 23. But the record demonstrates that the shift of production from marginal leases to more capable leases was part of a continuing process that had begun long before unitization. *See* Pet. 5 n.5.[4] All the petroleum engineering experts deposed in this case agreed that prior to March, 1977, unitization had had no

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[3] The projection of a $250 million profit that the government cites, *see* Br. in Opp. 9, was made before the institution of two-tier price controls. *See* R. 23880-82, 23410. Consequently, it did not contemplate the loss of large quantities of higher-priced new oil that would be caused by immediate adoption of a unit BPCL. It is that loss (quantified by the judgment below) that renders the project uneconomic.

[4] The government tries to plant the suspicion that Exxon was involved in "gerrymandering of boundaries undertaken to avoid price controls," Br. in Opp. 4, but the district court held that the government had failed to prove its contention "that Exxon in fact gerrymandered production." Pet. App. 260a.

substantial effect on this process, *i.e.*, that unitization had not caused significant incremental shifting of production. *See id.* at 17 n.15.

Third, the government repeatedly complains that Exxon's "lease-by-lease accounting practices . . . resulted in increasing amounts of new oil being reported even as actual production declined." Br. in Opp. 20. *See also id.* at 10-11, 18, 21 n.21, 24.[5] Actually, production at Hawkins Field increased between 1972 and September 1, 1976, and unitized operations were responsible for a portion of this increase. R. 31493-95. The annual rate of production declined thereafter, but such a decline is an inevitable part of the life-cycle of a mature producing field. The important point is that enhanced recovery served to slow or "arrest the declining production curve," R. 28775, thereby saving some 70 million additional barrels of crude oil. *See* Pet. 8. Enhanced recovery at Hawkins Field therefore unquestionably accomplished the regulatory objective of increasing the availability of domestic crude oil.[6] The amounts of new oil reported at Hawkins Field after September 1, 1976, simply reflected deliberate federal policy, *i.e.*, the encouragement of enhanced recovery reflected in the "imputed new oil" rule of 10 C.F.R. § 212.75.[7]

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[5] The government fails to acknowledge that increasing amounts of new oil also would have been reported in the absence of unitization. *See* Pet. 5 n.6. FEA explained many years ago that the regulations permitted the reporting of increased volumes of new oil, even as total production decreased, in any field governed, as is Hawkins Field, by Maximum Efficient Rate ("MER") rules. 41 Fed. Reg. 1564, 1571-72 (1976). *See also* Pet. 5 n.5.

[6] The government acknowledges that encouraging production was an important goal, Br. in Opp. 17-18, but prefers to emphasize that "one purpose of price controls was to control prices." *Id.* at 18 n.17. The two goals were intertwined: increasing the availability of domestic crude oil meant decreasing the importation of higher-priced foreign oil.

[7] One of the principal issues in this case concerns DOE's effort to deny to Hawkins Field the benefit of imputed new oil. The

Fourth, the government repeatedly creates the impression that FEA's Ruling 1975-15, which construed 10 C.F.R. § 212.72 to require adoption of a unit BPCL immediately upon unitization, for all practical purposes remains good law. *See, e.g.*, Br. in Opp. 4, 5, 11, 12, 16-17, 19-20, 21. It is appalling that the government would assert that "petitioner fails to give due deference to DOE's own interpretation . . . that Section 212.72 required a unit BPCL immediately upon unitization, an interpretation faithful to the language of the regulation and to the underlying statutory and regulatory purposes." *Id.* at 18. The agency itself squarely disavowed "DOE's own interpretation" when it rescinded Ruling 1975-15 *ab initio*, and it did so precisely because that interpretation was inconsistent with the regulatory purpose of encouraging enhanced recovery. *See* Pet. 8-11. FEA expressly repudiated the view, still urged by the government here, that § 212.72 should be read as requiring adoption of a unit BPCL immediately upon unitization and before the occurrence of a significant alteration in producing patterns.[8]

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government seeks to obscure this issue by consistently describing 10 C.F.R. § 212.75, with its benefit of imputed new oil, as applying only to units formed on or after February 1, 1976. *See* Br. in Opp. 5, 6, 8, 10. That is legal argument, not description. Nothing in the regulatory text limited the regulation's application to units formed on or after February 1, 1976 (or any other date). The regulatory preamble explicitly stated that units formed before that date would be subject to the new regulation. 41 Fed. Reg. 4931, 4937 (1976). Even FEA's Ruling 1977-2, which otherwise sought to contract the reach of § 212.75, acknowledged that it applied at least to some units formed before February 1, 1976. 42 Fed. Reg. 4409, 4414-15 (1977).

[8] The government now admits, for the first time in this case, that "several" (it should have said "all") of FEA's interpretations prior to Ruling 1975-15 were secret and therefore cannot be used against Exxon (and by implication were improperly relied upon by both the district court and the court of appeals). Br. in Opp. 18 n.18. Yet, curiously, the government repeatedly invokes those very interpretations to support its position here. *See* Br. in Opp. 4 n.4, 11, 18.

By ruling that units would be required to adopt a unit BPCL only when there had been a significant alteration in producing patterns, FEA was attempting to accomplish two very different objectives: to encourage enhanced recovery but at the same time to prevent artificial increases in new oil above levels that could have been reported in the absence of unitization. Lease-by-lease accounting at Hawkins Field—which only continued until September 1, 1976—was consistent with both of those objectives. It preserved the economic rationale for enhanced recovery by protecting against the arbitrary loss of new oil, yet it did not result in the reporting of inflated volumes of new oil. *See* Pet. 8.

We turn to the government's specific legal arguments on the merits of the questions presented.[9]

1. In its petition, Exxon showed that TECA fundamentally erred in adopting a construction of 10 C.F.R. § 212.72 that had been repudiated by FEA as substantively invalid. Pet. 27-29. The government's response is a model of avoidance and obfuscation.[10]

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[9] The government self-righteously attacks Exxon for calling the Court's attention to scholarly criticism of TECA. *Compare* Pet. 27 n.24 *with* Br. in Op. 15 n.13. The article we cite from the *Duke Law Journal*, which harshly criticizes TECA for exhibiting an "institutional bias" in favor of the government, was written by a law professor who had acquired substantial first-hand experience with TECA as a government attorney. *See* 1978 Duke L.J. at 113 n.*, 151. The American Bar Association, when it adopted a resolution urging Congress not to create another similarly constituted temporary emergency court of appeals in connection with any future emergency program, in part was responding to that and other such criticisms of TECA, which were referred to at pages 8 and 9 of the *Recommendations and Report* that we also cite.

[10] The government contends, first, that TECA's construction—requiring the adoption of a unit BPCL immediately upon unitization—was correct because TECA also had applied the same construction in other cases. Br. in Opp. 16-17. That contention, of course, is sheer bootstrapping. Moreover, of the four cases cited by the government only *Pennzoil Co. v. DOE*, 680 F.2d 156 (TECA

When the government finally addresses the real issue—TECA's enforcement of a regulatory interpretation that had been repudiated by the agency—it attempts to enshroud that issue in confusion. Br. in Opp. 19-20. The matter, however, is quite clear: when it rescinded Ruling 1975-15, FEA determined that a unit is a "property" required to adopt a unit BPCL *only* when there has been a significant alteration in producing patterns. The government offers no justification for TECA's refusal to abide by that official construction of the agency's own regulations.[11]

2. TECA's retroactive and discriminatory application of the August, 1976, amendments to 10 C.F.R. § 212.75 violated three important principles of administrative due process. Pet. 29-35. With respect to retroactivity, the government makes only one argument (although it is phrased to sound like two)—that retroactive application of the arbitrary and harsh August, 1976, definition was not prejudicial because otherwise Exxon would have been required under § 212.72, as construed by Ruling 1975-15, to adopt a unit BPCL immediately upon unitization. Br.

1982), *cert. dismissed*, 459 U.S. 1190 (1983), even arguably conforms to the government's description.

The government then introduces a straw man by mischaracterizing Exxon's argument, which is not that the regulation "required lease-by-lease accounting," Br. in Opp. 17, but rather that, as FEA specifically stated when it rescinded Ruling 1975-15 *ab initio*, the regulation permitted lease-by-lease accounting before the occurrence of a significant alteration in producing patterns.

The government next introduces a second straw man—estoppel—and, in the course of thrashing it, once again misrepresents the facts relating to the formation of the unit. *Compare* pages 1-2, *supra*, *with* Br. in Opp. 19.

[11] Indeed, the government elsewhere seems to disavow TECA's plainly improper ruling on this point by asserting that Exxon's liability really rests only upon the alleged occurrence of a significant alteration in producing patterns and not upon "the immediate unit-wide BPCL requirement." Br. in Opp. 17 n.16. That appears to be a very muted confession of error.

in Opp. 21-22. That argument, of course, collapses in the face of the agency's rescission of Ruling 1975-15.

Retroactivity is a crucial element of the government's case. The underlying question here is whether a significant alteration in producing patterns occurred at Hawkins Field before Exxon adopted a unit BPCL on September 1, 1976—a question that by its very nature requires the weighing and evaluation of evidence with respect to producing patterns. That necessarily is a matter for trial *unless* the arbitrary August, 1976, definition is applied retroactively—an application for which the government offers no meritorious rationale. If this Court rejects retroactive application and remands the case for trial, Exxon almost certainly will prevail: all of the expert witnesses—even DOE's—agree that producing patterns remained essentially unchanged at Hawkins Field until the implementation of enhanced recovery in March, 1977. *See* Pet. 17 n.15.[12] Thus, there is nothing "puzzling" or "curious," Br. in Opp. 12, 21, about Exxon's argument against retroactivity.

The government leaves wholly unexplained the irrationality of the classification used by the agency in awarding and denying the crucial benefit of imputed new oil. The government irrelevantly states that "it was completely reasonable not to apply the incentive provisions . . . to pre-existing units." Br. in Opp. 22. The legal issue here arises precisely because the benefit of imputed new oil—which was intended to provide mitigation as well as incentive—was denied to Hawkins Field but granted to many other "pre-existing units," *i.e.*, units formed before that benefit was added to the regulations on September 1, 1976. The benefit was made available to units formed on or after February 1, 1976, even if they

[12] The government argues throughout that Exxon would not be able to meet even the generic standard of "significant alteration in producing patterns." *See, e.g.*, Br. in Opp. 21 n.21, 24. The government's hopes in that regard, however, do not justify denying Exxon an opportunity to prove its case at trial.

had experienced a significant alteration in producing patterns before September 1, 1976; and it was even made available to some units formed before February 1, 1976. *See* Pet. 15, 18, 22 n.20, 33-34. The government is quite unable to justify or defend this discrimination.[13]

3. By denying Exxon a hearing on the question of a reasonable alternative date for adopting a unit BPCL, the lower courts not only approved but participated in a violation of the *Accardi* doctrine. Pet. 35-38. The government tries to brush aside this serious constitutional issue with the nonsensical argument that the occurrence of an alleged "substantial shift in production" made any alternative date "unreasonable as a matter of law." Br. in Opp. 23. Whether a shift in production rendered alternative dates unreasonable is precisely the kind of issue that can only be decided in a hearing of the sort contemplated and promised by Ruling 1977-2. The asserted shift in production was simply the natural evolution of a mature field governed by state MER rules—an evolution that would also have occurred in the absence of unitization—and the amounts of new oil actually reported approximated those that would have been reported in the absence of unitization. *See* pages 2-3, *supra*.[14] Those are appropriate factors for consideration under Ruling 1977-2, and Exxon has been denied any opportunity to present them to either the agency or the courts.[15] Moreover, the

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[13] The government's suggestion that the discrimination should be cured by withdrawing, long after the fact, the benefits conferred on other pre-existing units, Br. in Opp. 23 n.22, is simply bizarre.

[14] The evidence upon which the government relies is insubstantial. The supposedly dramatic "finding" (how the district court could purport to make findings on summary judgment has never been explained) that there was a "shift of 'almost 20 percent of 1975 production * * * across lease lines,' " Br. in Opp. 24, is just the district court's questionable interpretation of a handwritten note that had little intrinsic probative value. *See* R. 25506.

[15] The government's contention that the "courts below fully credited petitioner's evidence," Br. in Opp. 23, is absurd. Exxon's

alternative date Exxon advocates—the implementation of enhanced recovery in March, 1977—could not conceivably be unreasonable as a matter of law, because as early as February, 1976, the agency itself identified the "implementation of enhanced recovery" as an alternative date for adoption of a unit BPCL. *See* Pet. 11 n.11.[16]

4. TECA erroneously construed and applied section 209 of the ESA in a manner that destroys its essential character as an equitable remedy. Pet. 38-41. The government largely refuses to join issue on this point, limiting its response almost exclusively to the doctrine of "operator liability" without even attempting to square that doctrine with the language of the statute. *See* Br. in Opp. 24-27. In doing so, the government relies upon an asserted identity between this case and *Christmann & Welborn v. DOE*, 773 F.2d 317 (TECA), *cert. denied*, 54 U.S.L.W. 3252 (Oct. 15, 1985); the government justified the result there, however, on the ground that the operator had "made pricing decisions on behalf of all the owners" (No. 85-81, Br. in Opp. 9), whereas Exxon did not do that here. *See* Pet. 7, 23 n.22.[17]

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evidence with respect to the question of a reasonable alternative date was "not before the court," Pet. App. 226a n.38, because Exxon contended that that question could not be decided on summary judgment. *See* note 2, *supra*. (The government distorts this procedural background out of recognition by stating that Exxon "had not actually contended that its evidence established a reasonable alternative date." Br. in Opp. 12 n.9.)

[16] It is outrageous for the government to muddle the issue by speaking in terms of an "underground drive mechanism [that is] too complex and amorphous to be relied upon as a workable regulatory standard." Br. in Opp. 24. The implementation of enhanced recovery is readily auditable, for it is marked by the above-ground manufacture and injection of inert gas.

[17] The government chooses to ignore such obvious problems as the lower courts' assessment of prejudgment interest at grossly excessive rates, *see* Pet. 20 n.18, including hundreds of millions of

The government relies heavily on the notion that review must be denied because TECA has nationwide jurisdiction and the regulatory program has expired. Br. in Opp. 15. Yet, the United States has not hesitated to seek review, and this Court has granted review, in precisely such cases in the past where, as here, the government is contesting with private parties over enormous sums of money. *See, e.g., United States v. Chicago, B. & Q. R. Co.*, 412 U.S. 401 (1973).[18] The decision below works such a manifest injustice, and imposes such a staggering and improper monetary liability on a single litigant, that it cries out for correction. *Cf. Hughes Tool Co. v. Trans World Airlines, Inc.*, 409 U.S. 363 (1973). In these circumstances, and for the many reasons stated here and in the petition for a writ of certiorari, the petition should be granted.

Respectfully submitted,

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dollars of interest on money that Exxon not only never had received but actually had paid to other interest owners.

[18] That case involved a decision by the Court of Claims construing an expired provision of the Internal Revenue Code of 1939; the amount of taxes potentially in controversy there was considerably less than the amount at stake here. *See* 412 U.S. at 404-05 n.6.